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NASHVILLE, TENNESSEE

March 21 2003  
TN REGULATORY AUTHORITY  
DOCKET ROOM

IN RE:

CHATTANOOGA GAS COMPANY  
INCENTIVE PLAN ACCOUNT (IPA) AUDIT

)  
)  
) Docket No. 02-00928  
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NOTICE OF FILING BY ENERGY AND WATER DIVISION OF  
THE TENNESSEE REGULATORY AUTHORITY

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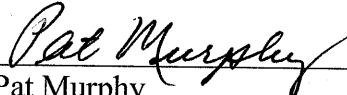
Pursuant to Tenn. Code Ann. §§ 65-4-104, 65-4-111 and 65-3-108, the Energy and Water Division of the Tennessee Regulatory Authority (hereafter "Energy and Water") hereby gives notice of its filing of the Chattanooga Gas Company Incentive Plan Account (hereafter "IPA") Audit Report in this docket and would respectfully state as follows:

1. The present docket was opened by the Authority to hear matters arising out of the audit of Chattanooga Gas Company's (hereafter the "Company") IPA for the year ended June 30, 2002.
2. The Company's IPA filing was received on August 30, 2002, and the Staff completed its audit of same on March 4, 2003. The earlier 180-day statutory deadline of February 26, 2003 was extended to April 21, 2003 by mutual consent of the Authority Staff and the Company, as provided for in the Authority's Purchased Gas Adjustment Rule 1220-4-7-.03(2).

3. The Staff's audit revealed no material findings. The Report is attached hereto as Exhibit A and is fully incorporated herein by this reference.

4. The Energy and Water Division hereby files its Report with the Tennessee Regulatory Authority for deposit as a public record and approval of the same.

Respectfully Submitted:

  
Pat Murphy  
Energy and Water Division  
Tennessee Regulatory Authority

**CERTIFICATE OF SERVICE**

I hereby certify that on this 21st day of March 2003, a true and exact copy of the foregoing has been either hand-delivered or delivered via U.S. Mail, postage pre-paid, to the following persons:

Sara Kyle  
Chairman  
Tennessee Regulatory Authority  
460 James Robertson Parkway  
Nashville, TN 37243

Mr. Archie Hickerson  
Manager - Rates  
Atlanta Gas Light Company  
Location 1686  
P.O. Box 4569  
Atlanta, GA 30302-4569

  
\_\_\_\_\_  
Pat Murphy

COMPLIANCE AUDIT REPORT  
OF

**CHATTANOOGA GAS COMPANY'S**  
**INCENTIVE PLAN ACCOUNT**

Docket No. 02-00928

PREPARED BY

**TENNESSEE REGULATORY AUTHORITY**

ENERGY AND WATER DIVISION

MARCH 2003

**EXHIBIT A**

**TENNESSEE REGULATORY AUTHORITY'S  
COMPLIANCE AUDIT  
of  
CHATTANOOGA GAS COMPANY'S  
INCENTIVE PLAN ACCOUNT  
Docket No. 02-00928**

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## **I. INTRODUCTION AND AUDIT OPINION**

The subject of this compliance audit is the Performance Incentive Plan ("PBR," "Incentive Plan," or "IPA") of Chattanooga Gas Company (hereafter "Chattanooga Gas" or the "Company"). The audit objective was to determine whether the Company had complied with the terms of its IPA tariff as of June 30, 2002. After reviewing the Company's gas purchases activity, along with the applicable benchmark indexes each month, Staff concludes that, during the plan year under review, the Company's gas purchases have met the criteria as specified its tariff. Therefore, for the plan year ending June 30, 2002, the Company is released from the prudence audit requirements encompassed in the Purchased Gas Adjustment Rule ("PGA Rule") 1220-4-7-.05. Section III of this report further describes the actual results of the plan year and Section IV details the Staff's findings.

## **II. BACKGROUND AND DESCRIPTION OF PERFORMANCE INCENTIVE PLAN**

On January 8, 2002, the Tennessee Regulatory Authority ("TRA" or "Authority") issued an Order in Docket Number 01-00619 approving a tariff to establish a performance-based ratemaking mechanism for Chattanooga Gas Company. The specific details of the mechanism are included in Chattanooga Gas' tariff entitled Performance-Based Ratemaking, which was issued on January 25, 2002, and was effective September 11, 2001.<sup>1</sup> A copy of this tariff is attached to the report as Attachment 1.

The tariff differs from traditional incentive plans in that the Company does not share in any profits or losses experienced when comparing its actual gas cost purchases against a preset benchmark. The "incentive" in Chattanooga Gas's case is a waiver of the prudence audit of gas purchases as required under the TRA's Purchased Gas Adjustment Rule.<sup>2</sup> The terms under which the prudence audit will be waived is found in the section Prudence Determination of the tariff.

"If Chattanooga's total commodity gas cost for the plan year does not exceed the total benchmark amount by one percentage point (1%) for a plan year ending after June 30, 2000, Chattanooga's gas cost will be deemed prudent and the audit required by Tennessee Regulatory Authority's Administrative Rule 1220-4-7-.05 is waived. If during any month of the plan year, the Company's commodity gas cost exceeds the benchmark amount by greater than two percentage points (2%), the Company shall file a report with the Authority fully explaining why the cost exceeded the benchmark."

<sup>1</sup> September 11, 2001 was the date of the Authority Conference during which the Directors voted to approve the Company's tariff petition with certain modifications.

<sup>2</sup> TRA Rule 1220-4-7-.05. The appropriate section of the rule is attached to this report as Attachment 2.

The Incentive Plan automatically rolls over for an additional plan year on each July 1<sup>st</sup>, and continues until the Incentive Plan is either (a) terminated at the end of a plan year by not less than 90 days notice to the TRA by Chattanooga Gas or (b) modified, amended or terminated by the TRA.

### **III. ACTUAL PLAN YEAR RESULTS**

On August 30, 2002, Chattanooga Gas filed its annual report as specified in its tariff, showing its actual cost of gas purchased and the applicable benchmark index for each month of the plan year ending June 30, 2002. The Staff reviewed applicable gas cost invoices and other supporting documentation supplied by the Company to verify whether the Company met the criteria necessary to be released from the requirements of the prudence audit. Below is a table summarizing the Company's monthly purchases as compared to the established benchmark.

<b>Month</b>	<b>Actual Purchase Cost</b>	<b>Benchmark Cost</b>	<b>Percentage Over/(Under) Benchmark</b>
July 2001	\$1,379,477	\$1,380,170	-0.05%
August 2001	1,382,166	1,387,451	-0.38%
September 2001	546,757	557,236	-1.88%
October 2001	1,408,742	1,478,134	-4.69%
November 2001	3,738,396	3,821,584	-2.18%
December 2001	2,456,524	2,510,985	-2.17%
January 2002	2,862,775	2,875,535	-0.44%
February 2002	1,629,474	1,641,614	-0.74%
March 2002	572,930	572,262	0.12%
April 2002	584,167	598,382	-2.38%
May 2002	563,956	563,950	0.00%
June 2002	813,279	837,536	-2.90%
<b>Annual Cost</b>	<b>17,938,643</b>	<b>18,224,841</b>	<b>-1.57%</b>

In every month except two, the Company was able to purchase gas at less than the pre-established benchmark for the month. And for total purchases for the year, the Company's purchases were 1.57 % below the total annual benchmark. Therefore, Chattanooga Gas has satisfied the criteria as set forth in its tariff and is released from the prudence audit for the plan year ending June 30, 2002.

#### **IV. IPA FINDINGS**

After reviewing the Company's filing, the Staff concluded that there were no material findings.<sup>3</sup>

#### **V. JURISDICTION OF THE TENNESSEE REGULATORY AUTHORITY**

Tennessee Code Annotated (hereafter "T.C.A.") gave jurisdiction and control over public utilities to the Tennessee Regulatory Authority. T.C.A. § 65-4-104 states:

The Authority has general supervisory and regulatory power, jurisdiction, and control over all public utilities, and also over their property, property rights, facilities, and franchises, so far as may be necessary for the purpose of carrying out the provisions of this chapter.

Further, T.C.A. § 65-4-105 grants the same power to the Authority with reference to all public utilities within its jurisdiction as chapters 3 and 5 of Title 65 of the T.C.A. has conferred on the Department of Transportation's oversight of the railroads or the Department of Safety's oversight of transportation companies. By virtue of T.C.A. § 65-3-108, said power includes the right to audit:

The department is given full power to examine the books and papers of the said companies, and to examine, under oath, the officers, agents, and employees of said companies...to procure the necessary information to intelligently and justly discharge their duties and carry out the provisions of this chapter and chapter 5 of this title.

The Authority's Energy and Water Division is responsible for auditing those companies under the Division's jurisdiction to insure that each company is abiding by the rules and regulations of the TRA. This audit was performed by Pat Murphy of the Energy and Water Division.

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<sup>3</sup> The audit goal is not to guarantee that the Company's results are 100% correct. Where it is appropriate, Staff utilizes sampling techniques to determine whether the Company's calculations are materially correct. Material discrepancies would dictate a broadening of the scope of Staff's review.



## Performance-Based Ratemaking

### Applicability

This Performance-Based Ratemaking Mechanism (PBRM) is designed to encourage the utility to maximize its gas purchasing activities at minimum cost consistent with efficient operations and service reliability. Each plan year will begin July 1. The annual provision and filings herein will apply to this annual period. The PBRM will continue until it is either (a) terminated at the end of a plan year or by not less than 90 days notice by the Company to the Authority or (b) modified, amended or terminated by the Authority.

### Overview of Structure

The Performance-Based Ratemaking Mechanism establishes predefined monthly benchmark indexes to which the Company's commodity cost is compared. This PBRM does not modify the method of calculating the Purchased Gas Adjustment as set forth in TRA Rule 1220-4-7 or provide for any sharing of gas cost in excess of the benchmark or savings when gas is purchased below the benchmark.

### Benchmark Index

Each month, Chattanooga will compare its actual commodity cost of gas to the appropriate benchmark amount. The benchmark gas cost will be computed by multiplying actual purchase quantities for the month, including quantities purchased for injection into storage, by the appropriate benchmark price index.

#### Spot Market Purchases:

The monthly spot market benchmark is the "Index" price published in the first issue of the delivery month of *Inside FERC's Gas Market Report* in the table titled "Price of Spot Gas Delivered to Pipelines," denoted in the column labeled "Index" and the row for the applicable "Pricing Point."

#### Swing Purchases

For swing purchases, the benchmark "Index" price for gas delivered on any day upon which *Gas Daily* is published, is equal to the Gas Daily-Midpoint price for the immediately following day under the heading "Daily Price Survey." For gas delivered on Saturday, Sunday, or any other day upon which *Gas Daily* is not published, the price index is equal to the Daily-Midpoint for the nearest subsequent day published by *Gas Daily*.

#### Long-term purchases

For long term purchases, i.e., a term more than one month, the "Index" price published in the first issue of the delivery month of *Inside FERC's Gas Market Report* in the table titled "Price of Spot Gas Delivered to Pipelines" denoted in the column labeled "Index" and the row for the applicable "Pricing Point" will be adjusted for the Company's rolling three-year average premium paid to ensure long-term supply availability during peak periods.

#### City Gate Purchases

For city gate purchases where gas is delivered by the supplier to the local distribution company, the indexes will be adjusted for the avoided transportation costs that would have been paid if the upstream capacity were purchased versus the demand charges actually paid to the supplier.

McLaughlin, President

Effective: September 11, 2001

Issued on: January 25, 2002

## **Performance-Based Ratemaking (Continued)**

### **Prudence Determination**

If Chattanooga's total commodity gas cost for the plan year does not exceed the total benchmark amount by one percentage point (1%) for a plan year ending after June 30, 2000, Chattanooga's gas cost will be deemed prudent and the audit required by Tennessee Regulatory Authority's Administrative Rule 1220-4-7-.05 is waived. If during any month of the plan year, the Company's commodity gas cost exceed the benchmark amount by greater than two percentage points (2%), the Company shall file a report with the Authority fully explaining why the cost exceeded the benchmark.

### **Filing with the Authority**

The Company will file an annual report not later than 60 days following the end of each plan year identifying the actual cost of gas purchased and the applicable index for each month of the plan year.

Unless the Authority provides written notification to the Company within 180 days of such reports, the annual filing shall be deemed in compliance with the provisions of this Service Schedule.

### **Periodic Index Revisions**

Because of changes in the natural gas marketplace, the price indices used by Chattanooga, and the composition of Chattanooga's purchased gas portfolio may change. The Company shall, within 30 days of identifying a change to a significant component of the mechanism, provide notice of such change to the Authority. Unless the Authority provides written notice to Chattanooga within 30 days of the Company's notice to the Authority, the price indices shall be deemed approved as proposed by the Company.

McLaughlin, President

Effective: September 11, 2001

Issued on: January 25, 2002

# ATTACHMENT 2

## PURCHASED GAS ADJUSTMENT RULES

CHAPTER 1220-4-7

(Rule 1220-4--7-.03, continued)

the Gas Charge Adjustment. Supplemental sheets showing the calculations of margin losses and cost savings shall also be provided.

3. Adjustments to Prior Period ACAs. In the event that circumstances warrant a correction to or restatement of a prior period ACA, such correction or restatement shall be made in accordance with the ACA calculation in effect for the time period(s) to which the correction or restatement relates. The resulting adjustment shall then be added to or deducted from the appropriate ACA in the next ensuing ACA filing with the Commission.
- (2) Annual Filing with the Commission. Each year, the Company shall file with the Commission an annual report reflecting the transactions in the Deferred Gas Cost Account. Unless the Commission provides written notification to the Company within one hundred eighty (180) days from the date of filing the report, the Deferred Gas Cost Adjustment Account shall be deemed in compliance with the provisions of these Rules. This ISO day notification period may be extended by mutual consent of the Company and the Commission Staff or by order of the Commission.

*Authority: T.C.A. §§65 -2-102 and TC.A. 65-4-104. Administrative History: Original rule filed October 29, 1993; effective March 1, 1994.*

**1220-4-7-.04 GAS COST ACCOUNTING.** To appropriately match revenues with cost of purchased gas as contemplated under these Rules, the Company shall originally record the cost of purchased gas in a "Deferred Gas Cost" account. Monthly, the Company shall debit "Natural Gas Purchases" with an amount equal to any gas cost component included in the Company's base tariff rates (base rate) plus the PGA rate, as calculated hereunder, multiplied by the appropriate volumes sold or billed to customers. The corresponding monthly credit entry shall be made to the "Deferred Gas Cost" account.

*Authority: T.C.A. §§65 -2-102 and TC.A. 65-4-104. Administrative History: Original rule filed October 29, 1993; effective March 1, 1994.*

### **1220-4-7-.05 AUDIT OF PRUDENCE OF GAS PURCHASES.**

- (1) The audit of prudence of gas purchases shall apply to Class A gas companies only. Class A gas company shall mean a local gas distribution company having annual gas operating revenues of two million five hundred thousand dollars (\$2,500,000) or more.
  - (a) Unless otherwise ordered by the Commission, the Staff and the LDCs shall prepare and issue a request for proposals and after reviewing the proposals, recommend to the Commission a qualified consultant to evaluate and report annually on the prudence of any gas costs included in the PGA. Subject to the approval of the Commission, a contract to perform the audit shall be awarded to the consultant to cover at least two consecutive annual audits.
    1. The scope of the evaluation shall be agreed to by the Staff and the LDCs and shall include guidelines to be used by the consultant in performing any such prudence review.
    2. Before selecting a consultant, the Staff and the LDCs shall determine the maximum amount to be paid for the audits that will be included in the contract. Each LDC shall pay to the consultant an equal portion of the cost of the audit(s).
    3. The amount paid to the consultant by an LDC shall be recorded in the LDC's Deferred Gas Cost Account and shall be recovered through the procedures set forth in these PGA rules.
  - (b) Each LDC shall file a non-binding gas purchase plan with the Commission at least annually.

PURCHASED GAS ADJUSTMENT RULES

CHAPTER 1220-4-7

(Rule 1220-4--7-.05, continued)

1. An LDC may, as its option, update the plan whenever it deems appropriate.
  2. The gas purchase plan shall include a general statement of the company's gas purchasing policies (e.g., the consideration given by the Company to the cost of gas, the security of the gas supply, the ability to obtain deliverability of the gas and other factors deemed relevant by the Company) which are established under the guidelines adopted under subsection (1)(a) of this Rule.
  3. All such plans shall be confidential and may be filed under appropriate protective orders.
- (c) In connection with the filing of the annual report of transactions in the Deferred Gas Cost Account required by Rule 1220-4-7-.03(2), each Class A LDC shall file a summary report detailing its gas purchasing practice during the period covered by the annual report. This requirement may be satisfied by the inclusion of such summary report information in the consultant's report that is required under section (1) of this Rule.
1. Within ninety (90) day after receipt of the gas purchase practices report information and the consultant's report, the Commission, in its discretion, may order a hearing to review the prudence of an LDC's gas purchasing practices and subject to the hearing, order the LDC to refund any imprudent gas costs collected under the provisions of the PGA Rules during the annual period under review. Any such order shall be subject to appeal in accordance with applicable law.
  - (3) If the commission does not order a hearing within ninety (90) day period, the LDC gas purchasing practices shall be deemed prudent.

**Authority:** T.C.A. §§65 -2-102 and T.C.A. 65-4-104. **Administrative History:** Original rule filed October 29, 1993; effective March 1, 1994.